NGC ENERGY RESOURCES, LIMITED PARTNERSHIP

IBLA 98-37 Decided June 18, 1999

Appeal from a decision of the Acting Deputy Commissioner of Indian Affairs upholding an order to produce documents. MMS 95-0762-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Payments

MMS had statutory and regulatory authority to require the first purchaser of gas production to provide copies of purchase and/or sales contracts and any processing, transportation, and exchange agreements that were needed as part of an audit to ensure that royalties had been correctly reported and paid.

APPEARANCES: Jerry E. Rothrock, Esq., and Kenneth P. Kaplan, Esq., Washington, D.C., for NGC Energy Resources, Limited Partnership; Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

NGC Energy Resources, Limited Partnership (NGC), has appealed the July 10, 1997, decision of the Acting Deputy Commissioner of Indian Affairs (ADC) denying NGC's challenge to a September 19, 1995, order of the Indian Audit Team (IAT), 1/ Minerals Management Service (MMS), directing NGC to provide MMS with copies of documents affecting Indian leases in the East Binger Unit in Caddo County, Oklahoma, including any gas sales contracts and any processing, transportation, and exchange agreements.

January 11, 1995, IAT issued what it has termed an "audit initiation letter," stating:

> The [MMS IAT] is initiating an audit of your firm's practices and procedures relating to the computation and payment of

1/ The IAT appears to be part of MMS' Royalty Management Program (RMP). The Sept. 19, 1995, order and January and June 1995 letters at issue herein were issued on RMP letterhead. For simplicity, we shall refer to IAT as the agency that initiated the audit and demanded the documents.

> royalties due on minerals removed from certain Indian leases contained in the East Binger Unit, MMS No. 896-000932-0 (Unit). As part of our initiative to improve the management of Indian properties, and as a response to various requests from the Bureau of Indian Affairs (BIA), we are auditing all Indian leases participating in the Unit. The audit will cover the period from January 1, 1987 through October 31, 1994. Therefore, any and all records related to those Indian leases on which you are a payor, working interest owner, or lessee of record, for this period must be retained and be available for inspection. In accordance with [the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) and 30 C.F.R. §§ 212.50 and 212.200], records which support royalty reports and payments on or after the date of this letter that affect this audit period must be brought to the attention of the MMS audit staff.

(Jan. 11, 1995, Letter at 1.) This letter was apparently sent to 23 different entities, including NGC. As noted below, NGC was neither a royalty payor, a working interest owner, nor lessee of record, so that this letter, by its own terms, did not apply to it.

However, on June 2, 1995, the IAT wrote NGC directly, requesting that NGC provide copies of (1) any purchase and/or sales contracts, and (2) any processing, transportation, and exchange agreements with respect to "gas and associated products" from "Indian leases participating in the East Binger Unit" for the month of April 1992. No response was received from NGC, and, on September 19, 1995, IAT sent it a letter stating that, under FOGRMA and the regulations at 30 C.F.R. § 212.51, MMS had the authority to request the records it had sought in its June 2, 1995, letter, and directing NGC to provide them by September 29, 1995. NGC appealed the September 19 order under 30 C.F.R. Part 290.

It is undisputed that NGC did not own an interest in the East Binger Unit during April 1992 or at any other time. (NGC's Supplemental MMS Statement of Reasons filed Jan. 11, 1996 (MMS SSOR), at 2, 5; NGC's Response to IAT Field Report filed Mar. 21, 1996 (MMS Response) at 4.) It is also undisputed that NGC was "a purchaser of natural gas" (MMS SSOR at 3; MMS Response at 4) and was "not responsible for any royalty payments to the government." (MMS Response at 4.) In its February 29, 1996, Field Report responding to NGC's MMS SSOR, IAT acknowledged that NGC was "the current purchaser of gas production from Indian leases participating in the [East Binger] Unit." (IAT Field Report dated Feb. 29, 1996, at 2.)

The ADC's decision held that the September 19, 1995, order correctly stated that MMS was entitled to the requested information under section 103(a) of FOGRMA, 30 U.S.C. § 1713(a) (1994), as implemented by 30 C.F.R. § 212.51. In particular, the decision held that, pursuant to section 103(a), persons "purchasing" gas are required to establish and maintain any records, make any reports, and provide any information that

the Secretary might, by rule, reasonably require for the purposes of implementing FOGRMA or determining compliance with rules or orders under FOGRMA. (Decision at 2.) The decision also rejected NGC's argument that, as a purchaser of gas, it was not required under 30 C.F.R. § 212.51 to maintain or produce records concerning a royalty audit of an unrelated entity. The ADC cited that regulation's provision that "[e]ach lessee, operator, revenue payor, or other person shall make and retain accurate and complete records" and pointed out that the regulation is not limited to payors of royalty. (Decision at 3.) Thus, the ADC held in effect that the Secretary had provided "by rule" for the coverage of persons "purchasing" gas.

The ADC also rejected NGC's contention that the order should be rescinded because of our holdings in Mesa Operating Limited Partnership (On Reconsideration), 128 IBLA 174 (1994), and Forest Oil Corp., 113 IBLA 30, 97 I.D. 11 (1990), 2/ which (NGC asserted) concerned MMS' attempt to hold a purchaser of natural gas liable for claimed royalty underpayments by unrelated companies. The ADC concluded that those decisions were inapplicable in this matter. (Decision at 4.)

The ADC rejected NGC's contention that IAT's September 19 order exceeded MMS' authority under FOGRMA and concluded that the requested records were directly related to the determination of gross proceeds, in order to ensure proper management of Indian properties. (Decision at 3.) Noting that IAT had stated the objectives of the audit in its January 11, 1995, audit initiation letter, the ADC held that all subsequent requests for records were properly required to accomplish those objectives and that NGC had failed to provide any evidence to support its assertion that IAT was not being "truthful" when it asserted that the records were reasonably required for carrying out its duties under FOGRMA.

On appeal to this Board, NGC continues to argue that the September 19, 1995, order exceeds MMS' statutory authority under FOGRMA. It concedes that MMS is authorized under section 103 of FOGRMA to adopt rules requiring the maintenance and production of those records that are reasonably required for purposes of its audit and investigation, but argues that the September 19 order did not claim that it was necessary or appropriate to conduct an inquiry or investigation of NGC with respect to any aspect of the East Binger Unit. It also argues that the order failed to demonstrate that the requested records were necessary for the Government audit or "reasonably" required within the meaning of section 103(a). (Supplemental Statement of Reasons (SSOR) at 3-4.)

NGC also claims that section 103(a) of FOGRMA permits the Government to require the production of records and information only when the Secretary has adopted a rule imposing such a requirement and when the information is reasonably required for the purposes of FOGRMA. Since

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2/ Forest Oil was reversed in part on other grounds not germane to this appeal. 9 OHA 68, 98 I.D. 248 (1991).

the Government has never adopted a regulation specifically requiring the purchaser of natural gas to maintain and produce records, it concludes, IAT's order exceeds MMS' statutory authority. Moreover, it asserts that the Government has the burden of demonstrating that it has lawfully adopted such a rule and that the information requested is reasonably required. It contends that, to the extent that 30 C.F.R. § 212.51 purports to regulate the conduct of "other persons" who are merely purchasers of natural gas and not responsible for royalty payments, it exceeds the Government's statutory authority under FOGRMA. NGC also avers that, even if 30 C.F.R. § 212.51 imposes the requirement to maintain records, it does not justify the September 19 order because the regulation does not require a purchaser of natural gas to maintain or produce records demonstrating that royalty payments of the owners of the leases are correct. It also argues that the request is unreasonable because MMS never attempted to obtain the requested records from the Indian lessees, and it should not be required to bear the costs and burdens of MMS' audit of unrelated third parties. (SSOR at 5-6.)

NGC contends that the ADC erroneously concluded that our decision in Mesa Operating, supra, was inapplicable under the facts of this case. It argues that in Mesa Operating the Board rejected MMS' attempt to hold a purchaser of natural gas liable for claimed royalty underpayments of unrelated companies that produced natural gas from an Indian lease merely because the purchaser remitted royalty payments to the Government on behalf of those producers. NGC claims that the information demands in the September 19 order would cause the same ill results that the decision in Mesa Operating sought to avoid. (SSOR at 6-7.) NGC also asserts that Forest Oil Corp., supra, provides an independent reason for rescinding the ADC's decision, in that we held therein that it would be unfair to hold an operator liable for the alleged royalty underpayments of nonoperating interest owners unless the operator had an opportunity to assert any and all defenses of the nonoperating working owners. Thus, NGC argues, under Forest Oil it has been unfairly deprived of any opportunity to raise defenses that may be available to the unrelated companies that MMS is seeking to audit. (SSOR at 7-8.)

In its answer, MMS submits that FOGRMA and the implementing regulations provide ample authority for MMS' order to produce the records. It cites section 103(a) of FOGRMA, which provides that a

> person directly involved in * * * purchasing * * * oil or gas subject to this chapter through the point of first sale or the point of royalty computation, whichever is later, shall establish and maintain any records, make any reports, and provide any information that the Secretary may, by rule, reasonably require for the purposes of implementing this chapter or determining compliance with rules or orders under this chapter.

30 U.S.C. § 1713(a) (1994). MMS notes that FOGRMA defines a "person" as "any individual, firm, corporation, association, partnership, consortium, or joint venture." 30 U.S.C. § 1702(12). It submits accordingly that

NGC is a "person" as defined by FOGRMA and that, since it purchased the gas at point of first sale, it is required by section 103(a) to provide the requested records. (Answer at 2-3.) MMS also contends that NGC is required to produce the records by 30 C.F.R. § 212.51(a), which provides that "[e]ach lessee * * * or other person shall make and retain accurate and complete records," and by 30 C.F.R. § 212.51(c), which provides that the "lessee * * * or other person required to keep records shall be responsible for making the records available for inspection." (Answer at 3.) MMS notes that nothing in FOGRMA or the regulations compels it to first attempt to obtain the records from the lessees. It argues its order was proper because it has the express authority to obtain the records from any person, including the first purchaser. Furthermore, MMS asserts that the records are reasonably required to establish royalty value because they show the lessees' gross proceeds as well as the deductions to which the lessee is entitled and thus are necessary to demonstrate that royalties were properly paid. (Answer at 5.)

MMS cites Santa Fe Energy Products Co. v. McCutcheon, 90 F.3d 409 (10th Cir. 1996), which affirmed our decision in Santa Fe Energy Products, 127 IBLA 265 (1993) (Petition for Reconsideration denied Feb. 3, 1994). In that case, Santa Fe Energy Products Company (Products) purchased crude oil produced from Federal leases by Santa Fe Energy Company (Energy), its affiliate. MMS ordered Products to produce sales contracts, exchange agreements, ledger entries, and settlement statements for its crude oil transactions with Energy, and we affirmed. We considered and expressly rejected Products' arguments that it was not obligated to respond to MMS' demand for documents because no rule had been promulgated to require production of documents beyond the point of first sale or royalty computation, and that MMS had no jurisdiction that would permit issuance of an order to Products to produce records of any kind because it was not signatory to the lease agreement. 127 IBLA at 266. The Tenth Circuit ruled that Products was "the first purchaser of oil produced by Energy under a federal lease" and was therefore, under section 103(a) of FOGRMA, supra, a "person directly involved in * * * purchasing oil or gas subject to this chapter through the point of first sale or royalty computation." Accordingly, the Court held (quoting section 103(a) of FOGRMA) that "Products was required to `establish and maintain any records, make any reports, and provide any information that the Secretary may, by rule, reasonably require for the purposes of implementing this chapter or determining compliance with rules or orders under this chapter.'" 90 F.3d at 414. The Court also held that the records sought by MMS were relevant to implementing royalty valuation under the gross proceeds rule, concluding that the records constituted "records necessary to demonstrate that payments of rents, royalties * * * are in compliance with lease terms, regulations, and orders," citing 30 C.F.R. § 212.51(a). Id.

MMS also refers to the Third Circuit Court's decision in Shell Oil Co. v. Babbitt, 125 F.3d 172 (3rd Cir. 1997), affirming our decision in Shell Oil Co. (On Reconsideration), 132 IBLA 354 (1995), which in turn affirmed an MMS order requiring Shell to turn over documents relating to oil Shell

purchased from its affiliate Shell Western E & P (Shell Ex), which produced the oil from Federal leases. The documents included sales contracts and verification of all revenue from Shell's re-sales of the oil to third parties. The documents were requested because MMS deemed them necessary to determine whether the nonarm's-length price Shell paid Shell Ex for the oil was acceptable for royalty valuation purposes. 125 F.3d at 174-75. The Third Circuit expressly rejected the argument (advanced here by NGC) that a lessee is not required to maintain and provide the ordered records unless it is responsible for paying royalty: "The plain language of section 212.51(a) makes clear that it applies to `other persons' in addition to operators and payors, and it does not make sense to read other persons as `other persons with paying or operating responsibility.'" 125 F.3d at 177.

NGC has responded to MMS' answer, reiterating its position that it is only the purchaser of the gas and has no responsibility for any royalty payment, and also that the IAT order lacks a rational basis because MMS has never explained why it cannot or should not request the audit materials from the lessees. It contends that MMS' reliance on Shell Oil and Santa Fe Energy is misplaced because neither case involves a situation wherein MMS was demanding that an unaffiliated purchaser of natural gas produce documents that MMS could more easily obtain from the lessees. NGC submits that in each case the court upheld a requirement that the lessee produce records concerning its sale of natural gas to an affiliated entity that resold the product at arm's-length to an unaffiliated purchaser. NGC argues that, because it is not and has never been affiliated with the lessees in the East Binger Unit, the decisions in Shell Oil and Santa Fe Energy do not support MMS' position. Furthermore, it argues MMS is attempting to extend Shell Oil beyond the narrow limits of the holding. In support of that argument, NGC cites the court's concluding statement "emphasizing that our ruling is narrow." 125 F.3d at 178. NGC also insists that Forest Oil is applicable to this appeal and that MMS' order would unfairly deprive it of its due process right to assert defenses of nonoperating working interest owners.

[1] FOGRMA requires the Secretary to "establish a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties." 30 U.S.C. § 1711(a) (1994); see Phillips Petroleum Co. v. Lujan, 963 F.2d 1380 (10th Cir. 1992). Administrative agencies vested with investigatory power have broad discretion to require the disclosure of information concerning matters within their jurisdiction. See Phillips Petroleum Co. v. Lujan, 951 F.2d 257, 260 (10th Cir. 1991). Accordingly, MMS has authority to demand production of documents relevant to royalty determinations. The questions here are whether MMS may demand documents from a purchaser who is neither affiliated with the lessee nor responsible for royalty payment and, if so, whether it must first seek them from the lessee.

> As noted above, section 103(a) of FOGRMA provides:
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> > A lessee, operator, or other person directly involved in developing, producing, transporting, purchasing, or selling oil or gas subject to this chapter through the point of first sale or the point of royalty computation, whichever is later, shall establish and maintain any records, make any reports, and provide any information that the Secretary may, by rule, reasonably require for the purposes of implementing this chapter or determining compliance with rules or orders under this chapter.
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> 30 U.S.C. § 1713(a) (1994) (emphasis added). The implementing regulation at 30 C.F.R. § 212.51(a) states in pertinent part:
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> > Each lessee, operator, revenue payor, or other person shall make and retain accurate and complete records necessary to demonstrate that payments of rentals, royalties, net profit shares, and other payments related to offshore and onshore Federal and Indian oil and gas leases are in compliance with lease terms, regulations, and orders.
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> (Emphasis added.) As to the inspection of records, 30 C.F.R. § 212.51(c) provides: "The lessee, operator, revenue payor, or other person required to keep records shall be responsible for making the records available for inspection." (Emphasis added.)

NGC admits that it is the purchaser of gas but argues that it has no responsibility for paying royalty and that 30 C.F.R. § 212.51 only requires a person who is responsible for the payment of royalties to maintain records.

Congress defined "person" for purposes of FOGRMA as "any individual, firm, corporation, association, partnership, consortium or joint venture." 30 U.S.C. § 1702(12) (1994). The statute does not limit the definition to royalty payors. Therefore, NGC is a "person" within the meaning of the statute. It is also the first purchaser of the gas. The Third Circuit, stating its agreement with the Tenth Circuit in Santa Fe Energy, concluded that section 103(a) covered "the first purchaser of oil * * * because such a purchase is a `person directly involved in * * * purchasing * * * oil or gas subject to this chapter through the point of first sale or royalty computation.'" Shell Oil, 125 F.3d at 176. Both courts concluded that the language of the statute required the first purchaser to maintain records. See Santa Fe Energy, 90 F.3d at 414; Shell Oil, 125 F.3d at 176. Neither court limited its ruling to royalty payors.

As was also noted by the Court in Shell Oil, 30 C.F.R. § 212.51(a) does not limit the recordkeeping requirement to lessees or royalty payors. The court stated that the "plain language of [that regulation] makes clear that it applies to `other persons' in addition to operators and payors, and it does not make sense to read other persons as `other persons with paying

or operating responsibility.'" Shell Oil, 125 F.3d at 177. The same logic applies in concluding that the regulation does not limit record keeping to affiliates of lessees or royalty payors.

Although NGC points out that the Secretary did not promulgate a rule requiring "persons" in its situation to maintain records and provide information, we regard 30 C.F.R. § 212.51(a) as adequate to meet the statutory provision requiring implementation "by rule." As noted above, the Courts in Santa Fe Energy and Shell Oil concluded that MMS had the authority to require the first purchaser to produce documents relevant to sales where such documents were reasonably required to determine royalty valuation on the basis of that regulation. Santa Fe Energy, 90 F.3d at 414; Shell Oil, 125 F.3d at 178.

NGC points out that the Court in Shell Oil stated that its ruling was "narrow" and argues accordingly that its ruling should not be extended to cover production of documents from a nonaffiliated third party that is not responsible for paying royalty. It is clear that the Court was concerned that its decision not be read as imputing Shell's liability for royalty to its affiliate Shell Ex because that issue was not before the court. However, the court specifically referred to an administrative agency's broad investigative authority. 125 F.3d at 178. Thus, we do not read Shell Oil to preclude MMS from seeking the records. Indeed the logic of that decision, as noted above, supports MMS.

NGC argues that the September 19, 1995, order exceeds MMS' statutory authority because the order did not claim that it was necessary or appropriate for an audit. The order stated that IAT was reviewing the computation and payment of royalties due on Indian leases in the East Binger Unit and that NGC had been notified of the audit initiation by letter of January 11, 1995, and a specific document request dated June 2, 1995. The January 11, 1995, letter informed NGC (and a number of other companies) that the IAT was initiating an audit of the lessees' "practices and procedures relating to the computation and payment of royalties due on minerals removed from certain Indian leases contained in the East Binger Unit, MMS No. 896-000932-0." It explained that the audit would cover the period from January 1, 1987, through October 31, 1994. Although the January 1995 letter was not directed to NGC (which was not a "payor, working interest owner, or lessee of record"), it did serve to explain generally why documents were required. Although IAT could have more expressly stated in subsequent documents why the April 1992 documents were required, it was evident that they were needed to ensure that the "payor, working interest owner, or lessee of record" had properly met its royalty obligations to the Indian lessors here.

We also reject NGC's contention that MMS should first seek the records from the appropriate lessee. Neither FOGRMA nor its implementing regulations require such action by MMS. To the contrary, the statute and regulation do require NGC, as one doing business with an Indian oil and gas lessee, to maintain records necessary to implement the statute and to provide that information to MMS upon request.

As the Court noted in Santa Fe Energy,

> Products' resale records constituted "records necessary to demonstrate that payments of rentals, royalties, net profit shares, and other payments related to offshore and onshore Federal and Indian oil and gas leases are in compliance with lease terms, regulations and orders." 30 C.F.R. § 212.51(a) (1984). Moreover, an administrative agency's authority to request records and undertake other investigatory functions is extremely broad. See United States v. Morton Salt Co., 338 U.S. 632, 642-43 (1950) (restating the breadth of an agency's ability to gather information which is analogous to a Grand Jury's power to "investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not").

Santa Fe, 90 F.3d at 414 (parallel citation omitted). Here, as in both Santa Fe and Shell, the price paid for production by the purchaser to the lessee is critical to determining value for royalty purposes. It is enough to justify production of documents here that MMS needs to confirm that that price has been accurately reported by the lessee.

Our decisions in Forest Oil and Mesa Operating are of no comfort to NGC. 3/ Both decisions concern liability for royalty rather than responsibility to make documents available. NGC is not being held responsible for any payments, but only to produce records that it is required by regulation to maintain.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is affirmed.

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David L. Hughes
Administrative Judge

I concur:

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Will A. Irwin
Administrative Judge

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3/ In Forest Oil, the appellant had been assigned and accepted the responsibility of making royalty payments and was liable for the royalty on the share of production attributable to other working interests. The Board found that there was inadequate notice as to the value of production for royalty purposes to the other lessees and set aside that part of the decision to allow the other lessees to respond to the findings regarding valuation of production. In Mesa Operating, the Board was unwilling to hold a person who had no interest in the lease responsible for making royalty payments in the absence of a regulation and a Payor Information Form explicitly stating that filing the form constituted the assumption of the obligation to pay royalty.